

USAID/Bulgaria

Annual Report

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Bulgaria

Performance:

Background: For the past six years, Bulgaria has made considerable progress in terms of establishing a viable market-based democracy, producing a regional model of ethnic tolerance, and moving forward with its main foreign policy priorities - EU and NATO accession. The country is already scheduled to become a NATO member in the spring of 2004 and the EU Council has confirmed its commitment to Bulgaria's January 2007 accession. Despite these impressive developments, reforms are far from complete; public confidence in governmental institutions has plummeted; and the average Bulgarian has not yet felt the changes for the better.

Several disturbing trends have continued to characterize Bulgaria's political life during the past three years: a growing gap between popular expectations and the political elite's agenda, plunging trust in the public institutions, and general disengagement from public life. This rising political apathy has been confirmed by the low voters' turn-out during the municipal elections in the fall of 2003. The general public remains skeptical of both the government and the opposition and is not mobilized to foster political changes. The ruling majority is further troubled by intensifying internal disagreements and poor coordination among the state institutions. Major deficiencies in the rule of law area further reinforce this plummeting public trust in state institutions. Corruption continues to plague Bulgaria at all levels and impedes economic growth and democratic development. Transparency International's Corruption Perception index showed deterioration for Bulgaria in 2003.

Over the past few years, Bulgaria has capitalized upon the good macroeconomic performance and strong financial discipline achieved following the adoption of a Currency Board in 1997 and the implementation of a tight fiscal policy thereafter. Real GDP growth has occurred for six consecutive years at an average rate exceeding 4%, thanks to strong domestic investment growth, fuelled by a rapid expansion of credit and further progress in structural reforms. Annual inflation has been kept to moderate single-digit levels for the last three years. Private sector accounts for almost 70% of the GDP, with small and medium-sized enterprises becoming the main source of economic activity. The government has balanced the budget deficit in 2003 and fiscal revenues have increased. The onerous foreign debt was cut down to 65.2% of GDP in September 2003. Exports have continued to increase in spite of the weak global market environment.

Despite this good macroeconomic performance, Bulgaria is still attempting to regain its real GDP pre-transition levels. Foreign direct investments, although starting to recover in 2003, have remained low due to the slowdown in privatization; administrative failure to design and implement cogent, integrated long-term economic policies; and the overall business climate. The last, though improving, continues to discourage investors with frequent changes in the legislative framework, weak commercial legal environment, deficiencies in contract enforcement, and burdensome administrative barriers. Bulgaria's economic progress is further slowed down by: lack of significant reform of the judiciary, low-level corruption and organized crime; political interference and delay in privatizing state telecommunications and tobacco monopolies; and a high trade deficit. The EU recognized Bulgaria as a functioning market economy but warned reforms must continue in order for it to cope with competitive pressure and market forces within the EU in the near term.

Persistent high unemployment (although recently declining to 13% from 17% officially) and low incomes have continued to exacerbate popular dissatisfaction. With a minimum monthly wage of \$68, an average salary of \$175, and an average pension of \$67, Bulgaria continues to have the lowest compensation levels in Central and Eastern Europe. Health care reform continues at an uneven pace and is often cited as a reason for public discontent. The health status of the population is well below the EU average.

Although HIV/AIDS infection rates continued to be low, a recent World Bank report warns about the possibility of a pandemic increase in the region.

While the Bulgarian Government remains committed to addressing these challenges, the pace of reform has mostly been uneven. Increasing disagreements within the ruling majority and constantly declining support to current government point to a growing uncertainty as to the future of the cabinet, whose current mandate runs through the spring of 2005.

U.S. Interests and Goals: The USG's highest priorities in Bulgaria are continuing support for the war on terrorism and enhanced regional stability. Situated in a highly volatile region, Bulgaria has managed to assert itself as a stable political and economic anchor in Southeastern Europe, contributing to the stabilization of the Balkan region and acting as a reliable partner of the U.S. and its allies over the past several years. In this context, the USG overarching goals are to ensure that Bulgaria remains a dependable ally and continues to play a stabilizing role in the region. In order to achieve that, the overall U.S. strategy in Bulgaria includes five top priority strategic goals: counter-terrorism, regional stability, enhanced rule of law, economic development and job creation, and strong democratic institutions and human rights. USAID contributes to all five strategic goals of the Mission's Performance Plan and directly focuses on three of them, within the framework of the newly approved strategy for Bulgaria's graduation from SEED assistance after 200.

Rule of Law (ROL) is the centerpiece of the USG assistance program, given that improvements in this area may determine the country's long-term stability as an ally and will be a major factor for its EU accession. To assist in the process of institutionalizing rule of law, USAID devotes resources to modernizing the court administration, increasing the capacity of legal professionals to apply the law equally and swiftly, and combating corruption and trafficking in persons. In the area of local governance, USAID assistance focuses on fiscal decentralization, building the capacity of municipalities to cope with increased responsibilities and supporting NGOs that advocate on behalf of local governments. This effort is complemented by community level activities, which provide increased opportunities for ethnic minorities and encourage greater ethnic tolerance. Building stronger civil society organizations, strengthening parliamentary practices, and improving the advocacy of the independent media further support Bulgaria's transition to a strong democratic society. On the economic front, USAID fosters the development of a competitive and thriving market economy as an approach to spread the benefits of increased prosperity for the majority of Bulgarians. In addition, increased economic prosperity encourages regional cooperation and enhances stability. USAID programs support the reform efforts of the Bulgarian government in creating a business-friendly environment that attracts investments and encourages the growth of small and medium enterprises. The direct technical assistance to individual firms and competitive industry sectors promotes trade and investments. In addition, USAID programs provide additional opportunities for access to financial resources, thus boosting the growth of the private sector and job creation. The Mission also addresses the adverse social impacts of transition through assistance in the pension reform area, healthcare financing, and labor market efficiency.

USAID activities are well integrated into the overall USG assistance program and are further complemented by the efforts of the Department of State (media, civil society, educational exchange), the Department of Agriculture (economic development), the Department of Justice (law enforcement and organized crime), the U.S. Treasury (tax policy and law enforcement), and the Peace Corps (community development).

Donor Relations: Donor coordination is functioning reasonably well in Bulgaria. The GOB has invested significant effort in taking the lead of coordinating the assistance of bilateral and multilateral donors, though results have been mixed. In addition to the GOB's initiative, all major donors continue to meet regularly to brief each other on recent developments, findings, new programs, and important missions. While USAID was the first donor to announce its graduation strategy, others are already thinking in the same direction, linking their completion dates to Bulgaria's EU accession in 2007.

The EU is the largest multilateral donor allocating approximately \$300 million per year with the primary objective to prepare the country for its EU accession. USG assistance programs are in general designed

to be consistent with the requirements which the country must meet for EU accession, thus complementing the European effort. The EU has the greatest potential for assistance in the judicial reform and public administration area. Their support to government agencies is entirely related to legislative harmonization and funds management, while policy assistance is primarily provided by UNDP, the Open Society Institute, the Dutch Embassy, and the World Bank. In the judicial area, USAID efforts for providing court automation equipment for model courts and developing the case management system software have laid the foundation for a nation-wide EU court automation project. Working together on commercial law issues, EU takes the lead in the area on bankruptcy, while USAID focuses on company registration, collateral issues, alternative dispute resolution on commercial matters and overall enforcement of commercial judgments. Although no other donor is comprehensively addressing local government reform, the Swiss Government, the British Government, and the World Bank complement USAID activities with demonstration projects on a limited geographic basis. Major donors coordinating efforts with USAID in the business environment area include the EU (strengthening associations and business consulting companies), GTZ (export promotion and association strengthening), UNDP (development of business support centers), the World Bank and DFID (regulatory framework improvement). The World Bank and USAID are the only donors supporting the healthcare reform in Bulgaria. While the Bank provides equipment and assists in the overall sector restructuring, USAID complements its efforts with key technical assistance. EU and UNDP focus on job creation and poverty alleviation by working with governmental institutions, while USAID approaches the issues by working at community level.

Challenges: After years of no-action, GOB demonstrated increased focus on the rule of law issues in 2003. The commitment to judicial reform has begun to broaden across the political spectrum and has resulted in several noteworthy achievements in the fall of 2003. Nevertheless, ROL deficiencies represent Bulgaria's most outstanding democracy issue, further exacerbated by corruption and organized crime. The deficiencies include: a lack of transparency and accountability, serious delays in the judicial system; legal professionals with inadequate legal expertise and experience; the politicization of the judiciary; human trafficking; and waste, fraud and abuse in government procurement and poor audit capacity. These issues feed general distrust in the public institutions, hamper business investment, and prevent Bulgaria from meeting the international and EU standards in the rule of law area. Given the growing internal disagreements within the ruling majority and poor coordination among the state institutions, the biggest challenge will be to sustain the reform efforts and even increase the pace of change. On the local level, the newly elected councils with their broader political representation might be a challenge for the productive functioning of the local governments. On the central level, political will for successful completion of the decentralization effort will drive the reform.

On the economic front, Bulgaria continues to be on the right track by maintaining the economic growth and financial stability. The development of a robust private sector as the engine for growth, job creation and economic prosperity is on-going. At the same time though, there are many Bulgarians who have not yet felt the change for the better. Living standards have not yet improved for all Bulgarians. Ethnic minorities, the long-term unemployed, people with low education continue to face poverty. One of the key challenges therefore is to ensure that growth generates wealth for all groups in society. To realize Bulgaria's potential and meet the aspirations of all, the country will also need to stay on course in tackling the remaining challenges in its transition agenda such as: the creation of an efficient and competitive business environment; finalizing second generation economic reforms with an emphasis on key privatization deals in the telecommunications, tobacco, and utilities sectors; putting in place better and transparent government system, and improving the quality and access of social services for all citizens.

Key Achievements: FY 2003 marked the beginning of a five-year period leading to graduation from USG assistance. A strategic document is in place to guide USG activities during the 2003-2007 timeframe and lay the groundwork for a post-graduation relationship between the two countries that serves as a strategic partnership in the region and strengthens the worldwide anti-terrorist alliance. The strategy identifies three areas as top priorities for USG assistance: enhanced rule of law, economic growth and increased prosperity with focus on job creation, and strengthened local governance. Throughout FY 2003, USAID assistance efforts were centered around the new strategic priorities with increased focus on building self-sustaining local capacity. Given the limited timeframe and diminishing resources, we have introduced a

more pragmatic approach to our work with the government. USG increasingly conditions support to key reform milestones that the GOB must meet. Collaboration with the government has been good and USAID made good progress on overall program objectives. Two of our strategic objectives exceeded expectations reaching significant results after years of modest progress. USAID successfully completed its bank privatization and capital markets development projects leaving tangible results.

Rule of Law: Under this revised SO, USAID supports the justice sector reform and strengthens GOB's institutional capacity to prevent corruption and enhance transparency and accountability, especially in the area of government audit, internal controls, and public procurement. After dragging on for years, the reform efforts of the government finally moved into a direction that has been inspired by USG and other donors' assistance. The most significant achievements during the past year were the constitutional amendments involving accountability of magistrates, the establishment of the National Justice Institute (NJI) to train magistrates, and the adoption of the electronic case management system. U.S. and European lawyers provided a comparative law perspective for the constitutional amendments. In addition, USAID played a pivotal role in bringing the political parties into the dialogue. Prior USAID assistance established the Magistrate Training Center, a private NGO, which will now be transformed into the NJI. When the transformation process stalled in early 2003, the USG conditioned future training assistance on a series of milestones, all of which were met by November 2003. The modernization and expansion of court administration/case management practices continued with major USAID involvement.

A significant part of USAID assistance efforts in 2003 focused on fighting corruption through technical assistance to the GOB and grants to civil society organizations. Although this activity met expectations, the achievements are fragile. Two Bulgarian ministries received assistance to streamline their internal control units (similar to IGs) by working with inspectors to develop and adopt procedures that will ensure orderly performance of operations and guarantee adherence to effective management policies for fraud prevention and detection. USAID also assisted with the drafting of the new Public Procurement Law and related secondary legislation. Four pilot municipalities received support to develop a standardized documentation package for public procurement. Civil society lobbying efforts resulted in passage of ombudsman legislation in 2003. USG grants supported NGOs to pursue initiatives addressing anti-corruption public awareness, advocacy, monitoring, and investigations of corruption. The investigations uncovered problems with public procurement, government concession contracts and municipal property management, and have been turned into a "Sixty Minutes" type nationally broadcast TV program.

Economic Growth and Increased Prosperity: Through this SO, the Mission seeks to foster the development of a competitive, transparent, and business-friendly environment that is conducive to job creation, private sector growth and long-term prosperity. Over the course of the year, SME sector continued to grow more rapidly and create more jobs and incomes than the state owned enterprises. USAID assistance largely contributed to that effect. In FY 2003 alone, more than 2,600 private businesses were assisted through various business consultancy projects that resulted in 1,036 new jobs and another 614 jobs retained. To provide additional opportunities for growth of the private sector, USAID continued to expand the two micro-finance programs in the existing and new program centers, targeting the smallest and most disadvantaged micro-entrepreneurs. By September 2003 the number of active clients increased to more than 5,400 (71% to women), which represents a 32% increase compared to FY2002. The micro-lending programs helped create more than 2,900 new jobs and sustain close to 16,000 jobs in the country. To further improve access to credit, USAID continued to implement 3 loan-guarantee schemes by guaranteeing 50% of the risk. The three facilities implemented by two Bulgarian banks placed 163 loans exceeding \$15 million in 2003. Two new agreements were signed in late FY 2003 to stimulate lending to the agricultural sector in Bulgaria.

FY 2003 marked the successful completion of US-backed bank privatization in the country and the end of USAID support to the capital markets, leaving stable institutions and a regulated market, though still operating with limited volumes. The Mission launched two new programs - a commercial law reform program to address issues such as contract enforcement, company registration, business dispute resolution and collateralized transactions; and an energy program to strengthen the energy regulator. Support to Bulgaria's pension reform continued, thus helping the country to preserve its position as a regional leader in the area and serve as a model for its neighbors. USAID assistance was instrumental in

improving the transparency in the system and in ensuring a higher level of protection for employees' contributions. With Mission's support the government continued to address the efficiency of the labor market both at national and municipal level. Results of the assessments of the local labor markets completed in four pilot municipalities will serve as a basis for the introduction of employment promotion measures.

Local Governance: This revised SO focuses on implementing fiscal decentralization, enhancing the capacity of municipalities to function in a decentralized environment, and on increasing the ability to address community building issues through increased local participation and increased community ability to generate resources to address their own problems. Dominated by the municipal elections in October 2003, the past year witnessed major legislative actions that provide the basis for more effective and accountable governance at the local level. USAID assistance was the driving force behind these developments. Legislative changes allow for the establishment of a municipal ombudsman, prohibit councilors from serving on municipal company management boards and provide for greater citizens' access to council meetings. The Municipal Budget Act adds significant transparency and predictability to intergovernmental fiscal relations, differentiates between centrally mandated services and local services, requires public hearing in the budget process, and provides for municipal borrowing. Municipalities continued to demonstrate willingness to introduce new, more effective and participatory practices for local economic development and municipal marketing. The number of Citizen Information and Service Centers continued to expand, now totaling 76, with a broader base of funding. Many municipalities revised local fee schedules to cover service costs. As a result, their own source revenues grew significantly faster than in previous years. All these successes are the direct outcome of USAID long-term assistance. The local elections in October 2003 demonstrated the evolution of local government. Fifty-four percent of the incumbent mayors who ran were re-elected.

Assistance to the NGO sector continued at the community level and addressed fundraising issues, insufficient service offerings - particularly in the social sphere, and low citizen participation. USG programs fostered the establishment of public-private alliances by engaging the private sector, local government, and average citizens in resolving community issues. Community Funds were established in five cities. The ethnic integration efforts created models for addressing social, educational and economic problems in towns with large Roma populations. The GOB program for the social integration of Roma was developed with major USG assistance.

Trade Capacity Building: Bulgaria has been a member of the WTO since 1996. Foreign trade plays an important role in country's economy. In spite of the high trade deficit, exports continue to grow. USAID programs contribute to these developments by providing relevant firm level technical assistance. Mission assisted companies registered close to a 15% increase in exports, enlisted over \$21 million in business linkages and more than \$16 million in aggregate domestic sales. With USAID support, a significant number of Bulgarian companies introduced quality management standards, and 122 companies have adopted international business practices and industry standards. Such certifications greatly facilitate access to international market and are normally prerequisite for integration in international supply chains.

Country Close and Graduation:

Results Framework

183-0130 Economic Growth and Increased Prosperity

- 1.3.1. Improved Business Climate
 - 1.3.1.1. Improved and Transparent Legal and Regulatory Environment (in cooperation with US Treasury and USDA)
 - 1.3.1.2. Improved Social Sector Performance to Promote Business Opportunities
 - 1.3.1.3. Effective Legal Policies and Practices to Promote Transparency (in cooperation with ROL team)
- 1.3.2. Jobs Created through Strengthened Private Sector
 - 1.3.2.1. Sustained SME Growth
 - 1.3.2.2. Trade Capacity Built and Promoted
 - 1.3.2.3. More Efficient Labor Markets
- 1.3.3. Improved Access to Financial Resources
 - 1.3.3.1. Reduced Barriers to Credit
 - 1.3.3.2. Increased Investment in the Economy
 - 1.3.3.3. Sustainable Micro-lending Mechanisms Developed
- 1.3.4. A More Competitive Agricultural Sector, USDA

183-0140 A More Competitive and Market Responsive Private Financial Sector

183-0210 Increased, Better-Informed Citizens' Participation in Public Policy Decision-Making

183-0220 Enhanced Rule of Law

- 2.2.1. A Strengthened Judicial System
 - 2.2.1.1. Improved Court Administration
 - 2.2.1.2. Improved Capacity of Legal Professionals
 - 2.2.1.3. Key Laws and Regulations Support Effective ROL
- 2.2.2. Reduced Corruption through Enhanced Transparency & Accountability
 - 2.2.2.1. Procurement Policies and Procedures Enacted and Implemented to Increase Integrity
 - 2.2.2.2. Strengthened External and Internal Audit Mechanisms
 - 2.2.2.3. Increased Capacity of CSOs and Media to Demand Greater Transparency and Accountability of Public Institutions
- 2.2.3. Improved Law Enforcement Mechanisms (US Treasury, DOJ)
 - 2.2.3.1. Regional Criminal Justice against organized crime
 - 2.2.3.2. Prosecutorial Strengthening
 - 2.2.3.3. Frauds and Financial Crimes Task Force

183-0230 Local Governance More Effective and Accountable

- 2.3.1. Authority, Responsibility & Resources Decentralized to Local Government
 - 2.3.1.1. Key Laws to Support Decentralization in Place
 - 2.3.1.2. Increased Fiscal and Administrative, Decision-making and Service Delivery Capacity of Local Government
- 2.3.2. Increased Ability to Address Community Building Issues
 - 2.3.2.1. Increased Citizen Participation, Especially by Vulnerable Groups, in Policy Decisions
 - 2.3.2.2. Increased Community Generated Resources to Address Local Problems

183-0410 Special Initiatives

183-0420 Program Support Objective